Homeownership in Malaysia: An Analysis of Trends and Issues

by Dr. R. Thillainathan

INTRODUCTION

This paper deals with key trends, developments and issues in finance institution financing of homeownership in Malaysia from the 1970s. After a brief discussion of the flow of funds to the housing sector, there is an extensive discussion of the finance institution financing of homeownership. This section examines the role of all the key players in the origination and financing of housing loans, namely the commercial banks, the finance companies, the Treasury Housing Loan Division (THLD) and the two building societies, i.e., Malaysian Building Society Berhad (MBSB) and Borneo Housing Mortgage Finance Bhd (BHMFB).

This section also is divided into several subsections, covering the changing dynamics and pricing of housing loans; the origination, financing and refinancing of housing loans; and the issues related to mandated lending for housing. The conclusions of the paper are set out in a final section.

FLOW OF FUNDS TO THE HOUSING SECTOR

The flow of funds to the housing sector that we consider here is for the financing of homeownership. There are no readily available data on the flow of funds for the financing of housing development. Such data are in fact lumped together under building and construction.

To clearly identify the flow of funds into housing loans, it is best to discuss these flows by reference to the originators as well as financiers of the housing loans.

In the private sector, housing loans can be originated both by institutions within the financial system (for which data are readily available) as well as by non-financial private enterprises (dubbed NFPEs in this paper and for which data are not readily available). NFPEs give out loans almost exclusively to their employees and invariably on subsidized terms. The non-availability of data for housing loans provided by NFPEs is not material (so long as we do not consider privatized government enterprises, on which more will be said later) as very few NFPEs give housing loans to their employees.

The housing loans originated by the public sector, which function is entrusted to the Treasury Housing Loan Division (THLD), can be financed either by the public sector or by the financial system. As will be readily evident from the discussion to follow, the THLD is a big originator as well as a financier of housing loans.

Tables 1 and 2 give data on the absolute as well as the relative size of the flow of funds into housing loans. From 1960 to 1990, financing of homeownership accounted for between 8.0% and 13.4% of the total loans and advances of the financial system. However, the flow of funds into housing loans increased quite dramatically to 20.6% by 1995.

To gauge the relative size of the flow of funds into housing loans originated by the THLD is a little more difficult. The housing loans of the THLD which are financed by other entities in the private sector, which presumably includes the financial system, during the two years, 1990 and 1995, have been equal to 3.6% and 4.8% if they are expressed as a percentage of the total loans of the financial system. The housing loans of the THLD which were funded by federal government loans, when expressed as a percentage of the financial system's loans, amounted to 2.2% in 1980, 3.9% in 1990 and 3.0% in 1995.

Housing loans originated by the financial system thus absorbed 12.5% of the funds of the financial system flowing into their lending activities in 1990 and 20.6% in 1995. The flow of funds into housing loans which were originated by the THLD may have been as high as 7.5% and 7.8% expressed as a percentage of the resources of the financial system committed to its lending activities in 1990 and 1995.

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Table 1. Loans and Advances of the Financial System to Housing and the Broad Property Sector

						Average Annual Growth Rate (%)				
	1960	*1970*	*1980*	*1990*	*1995*[1]	*60–70*	*70–80*	*80–90*	*90–95*	*60–95*
i. RM MILLION										
Housing [2]	87	315	3,884	17,657	37,485	13.7	28.6	16.3	16.2	18.9
Building & Construction (incl. real estate)	20	260	4,115	21,717	40,805	29.2	31.8	18.1	13.4	24.3
Broad Property Sector	107	575	7,999	39,374	78,290	18.3	30.1	17.3	14.7	20.7
Total Loans	680	3,931	28,921	141,560	182,079	19.2	22.1	17.2	5.2	17.3
ii. As % SHARE OF TOTAL LOANS										
Housing	12.8	8.0	13.4	12.5	20.6					
Building & Construction (incl. real estate)	2.9	6.6	14.2	15.4	22.4					
Broad Property Sector	15.7	14.6	27.6	27.9	43.0					
Total Loans	100.0	100.0	100.0	100.0	100.0					

Notes:

[1] The data for 1995 on total loans have been extracted from Table A.37 and that on loans to building and construction are the numbers only for commercial banks, finance companies and merchant banks (and to that extent it is marginally underestimated) as extracted from Tables A.43 to A.45 of BNM's *1996 Annual Report*. The data on housing loans for 1995 have also been extracted from BNM's *1996 Annual Report* but adjusted to include the loans sold to Cagamas Berhad based on data supplied by Cagamas Berhad.

[2] These housing loan figures are only in respect to those given out by the Financial System and do not include the loans given out by the Public Sector to Its employees (See Table 2) and by the non-financial private enterprises to their employees. No estimate of the flow of funds to housing are available for the last category.

Source: (i) Bank Negara Malaysia, *Money And Banking in Malaysia*, 3rd & 4th Editions, 1989 & 1994
(ii) Bank Negara Malaysia, *Annual Report*, 1996

FINANCING OF HOMEOWNERSHIP

Changing Dynamics of Housing Loans

MBSB, which was set up in the early 1950s, has been granting housing loans on a term-loan basis with a fixed schedule of repayment from the outset. The commercial banks provided few or no home loans on a term-loan basis at least until the mid-60s. They may have provided some loans for the purchase of houses on an overdraft basis in the '60s; but from the available data it appears that this was not an important activity for the commercial banks. By the mid-70s, the commercial banks had emerged as the biggest providers of home loans. The mismatch in the maturity profile of a housing loan and the deposit liability of a commercial bank combined with interest rate control may have discouraged a commercial bank from venturing into this activity in an active manner in the '60s.

In any case, in that period the view that each type of financial institution should be a specialist and not a generalist was commonly accepted. Commercial banks tended then to specialize in the provision of trade and working capital finance. These were short-term, self-liquidating facilities and matched the funding position of commercial banks.

The above relates to housing loans granted by the private sector financial institutions; these loans are invariably at market rates. The government instituted a housing loan scheme at a subsidized interest rate of 4% p.a. (except during the austerity period of the mid-80s, when the rate was raised to as high as 6%

Table 2. Housing Loans of the Treasury Housing Loan Division (THLD) and Sources of Its Financing (RM million)

	1973	1980	1990	1995	73–80	80–90	90–95	73–95
1. Treasury Housing Loans Outstanding[1]	251	1,103	11,774	16,495	23.6	26.7	7.0	21.0
2. Outstanding loans due to Federal Government from all borrowers	2,462	11,132	43,039	45,618	24.1	14.5	1.2	14.2
3. Source of Financing[2] (RM million)								
a. Federal Government	100	643	5,473	5,473	30. 5	23.9	0.0	20.0
b. Cagamas Berhad	-	-	1,173	2,203	-	-	13.4	
c. Others	151	460	5,128	8,819	17.2	27.3	11.5	20.3
4. Source of Financing (%)								
a. 3 (a) ÷ 2	4.1	5.8	12.7	12.0				
b. 3 (a) ÷ Total Loans of Financial System		2.2	3.9	3.0				
c. 3 (c) ÷ Total Loans of Financial System		1.6	3.6	4.8				

Notes:

[1] These are housing loans given by the Treasury Housing Loan Division to government employees. The housing loans given to employees of statutory bodies are also included in these figures. However, a statutory body which is privatized, such as Syarikat Telekom Malaysia, is required to refinance the housing loans its employees have with the government once the entity is privatized. There is a reference to this requirement on p. 132 in the *1988 Annual Report* of BNM. Otherwise, they are required to pay the THLD an interest subsidy based on the difference between the cost of funds and the rate payable by the housing loan borrowers. The employees of government-owned companies registered with the Registrar of Companies are not eligible for subsidized housing loans from the THLD unless these employees are on secondment from the government.

[2] It is assumed that the figures on "Housing Loans to Government Officers" given in the Tables in the *Treasury Economic Reports* on "Outstanding Loans Due to Federal Government" represent the housing loans of the THLD which are funded directly by the federal government. The data on THLD's housing loans refinanced with Cagamas Bhd is obtained from Cagamas Bhd. As Cagamas Bhd is part of the financial system, the data on loans extended to housing in Table 1 is taken to include refinancing with Cagamas Bhd. "Others" as a source of financing is derived as a residual but from available data the institutions providing the financing cannot be readily identified except for 1996 for which the breakdowns are as follows: federal government, 40.3%; banks, 11%; Cagamas Bhd, 27%; and Employees Provident Fund, 16.2%. (See BNM, *Annual Report*, 1996, p. 123)

Sources: (i) Banlt Negara Malaysia *Annual Reports*
(ii) Ministry of Finance, *Treasury Economic Reports*

p.a.) as part of its employment policy from 1970.[1] The repayment period of these loans was 15 years initially and was increased to 25 years in 1980.

In the 70s, the average duration of the home loans provided by the private sector was 10-15 years. By the mid-80s the average duration of the home loans structured as term loans had increased to 15–20 years. In fact, one or two banks such as Citibank were also making home loans partly as overdraft facilities (with the overdraft portion carrying a higher interest rate and with no restrictions on prepayment).[2] In the '90s the average duration of term home loans has increased to 20–25 years with provision for inter-generational transfer of such loans from parents to children.[3]

From the mid-80s home loans were also structured so as to permit a progressive increase in monthly payments on a graduated or periodic basis in line with the increasing debt service capacity of borrowers based on the profile of earnings over their life cycle. During the initial sub-period, installment payments can be restricted to the interest to be serviced. However, such payments cannot be fixed below the interest amounts, as the difference cannot be recognized as income by the financial institutions.

Affordability Issues

These developments in the structuring of the loans were aimed at increasing the affordability of houses given the increase in house prices from the 70s. In the 70s the average value of a two-story terrace house in the Klang Valley

area would not have exceeded three times the annual salary of a fresh university graduate. The ratio of house prices to annual salaries had more than doubled by the 90s. The ratio is around 10 for an apartment in Singapore and three for a house in Australia.[4]

Shortage of development land and rapid economic growth may account for the significant differences in this ratio. But in the case of Malaysia, attempts by regulators to capture rents from land alienation and conversion may have made for a higher ratio. The extent of this problem, however, has been less since the late 80s as a result of the emergence of bumiputras and certain state entities as major developers.

In deciding on the margin and amount of advance to a prospective borrower, a bank will look at the debt servicing capacity of the individual. Under normal circumstances, the size of the loan will be such as to ensure that the monthly installment falls between one-fourth and one-third of the individual's monthly earnings.[5] The bank will be more conservative and hence permit a lower monthly installment as a percentage of earnings with respect to borrowers who are own-account workers or salesmen, as compared to those who are on fixed monthly salaries and whose jobs are more stable.

To avoid foreclosure actions in the event of death, the bank requires a borrower to take a decreasing term assurance policy over the life of the mortgage. In addition, the borrower also has to take an insurance policy on the house in the form of fire or house owner's policy against fire and theft in order that his debt servicing ability is not undermined by such unforeseen contingencies. An insurance to protect household effects will be required only if the bank or its subsidiary has extended additional loans for renovation or the purchase of such household effects.

Impact of Competition on Terms

In the face of keen competition for housing loans, some banks are making pre-approved loans with a margin of finance of 80% to 85% (as compared to 70% or less initially) for first-time house buyers, especially for low- and medium-cost houses. These banks are even prepared to make such offers for high-cost houses priced around RM500,000. The competition is so keen that banks are in fact making these offers at launches of new housing schemes, even going to the extent of issuing their offer letters to their prospective borrowers on the spot (i.e., within half an hour of their housing loan applications). This means that the banks are prepared to market their offer without a credit check on the premise that if a prospective borrower is able to come out with equity of 15% to 20% of the purchase price, then he should be earning enough to service the monthly loan.

Some banks have just started offering Islamic house financing. This is roughly equivalent to a conventional fixed-rate housing loan. The individual buying the house enters into an agreement in which the offering bank takes title to the house and agrees to resell it to him on a future date and at a price agreed now in return for making an initial downpayment and making a fixed monthly payment over the purchase period. The difference between the purchase and resale price will depend on the downpayment and the fixed rate of profit (which will be equivalent to a fixed rate of interest for a conventional housing loan) the bank wants to earn on the transaction. If the bank is funding this transaction by taking floating rate deposits, then the bank is exposed both to liquidity as well as interest-rate risks; and the risks are higher the longer the period for which the Islamic house financing is made. To minimize such risks, the central bank has deemed that the transacting bank should mobilize long-term funds priced on similar Islamic principles to finance these fixed-price homeownership activities.

Pricing

Almost the only choice open to borrowers who are buying high-cost houses, defined here as houses priced above RM100,000, is to borrow on a floating-rate basis. Housing loans priced on a fixed-rate basis for high-cost houses have made their appearance since 1995, but the number of institutions and the volume of funds available for lending on such a basis is strictly limited.

The floating-rate loans are priced over the base lending rate. The margin charged over the base lending rate will depend on the credit standing of the borrower and usually ranges from 1% to 2%.

Life-insurance companies which have access to long-term fixed-rate funds have been making fixed-rate loans for some years. This has been on a very limited scale, however, until the American International Assurance Company Ltd. (AIA) entered the market in a big way in 1994. AIA has been making fixed-rate loans for durations of 15 to 25 years, depending on the age profile and the credit standing of the borrower. Currently AIA is charging a fixed rate of 9% p.a., and any prepayment over the first six years of the loan is subject to a penalty charge of 0.25% p.a. on the unexpired portion of the six-year period.

A few commercial banks and finance companies are also making housing loans with interest rates fixed for periods of three-to-seven years, with a repricing of the loan on a variable-rate basis at a pre-agreed margin above the base lending rate or at a mutually agreed fixed rate to be determined at the end of the relevant period. Malayan Banking Berhad (Maybank) was the first financial institution to make such a loan, but a few others have followed suit, such as Bank of Commerce Berhad, Eon Bank, Southern Bank and Hong Leong Finance Institution. Currently Maybank's fixed rate is 9% p.a. for three years and 9.25% p.a. for five years. Hong Leong

Finance Institution, which entered the market a little later, has been a little more aggressive, offering a three-year fixed rate of 8.8% p.a.

Interest Rate Issues

The interest rates on loans for houses priced at RM100,000 and below have been subject to an interest-rate ceiling since October 1978. It was initially set at 9% but was revised up to 10% in April 1981. In March 1985, in the face of continued high interest rates, the ceiling interest rate on houses priced between RM 60,000 to RM100,000 was raised further to 11%. From April 1987, as a result of a substantial change in the interest-rate environment, the interest rate on low- and medium-cost houses was reduced to 1.75% over the base lending rate or 9%, whichever is lower. It has remained there since then.

As a result of monetary tightening in 1992 and 1993, and to ensure that financing is readily available for the purchase of medium- and low-cost houses, the government decided to provide, for the first time, an interest subsidy amounting to 1% to commercial banks and finance companies for new housing loans which were approved for such houses for the period beginning November 2, 1992. This was in force until March 1994. The total interest subsidy claimed by the commercial banks and finance companies amounted to RM8.4 million and RM3.5 million respectively.

It is only since the late 80s that the commercial banks and finance companies have had access to fixed-rate funds through a refinancing of their home loans from Cagamas. Because they were required to lend under a ceiling rate, these finance institutions had to accept a lower return and higher interest rate risk.

Now these finance institutions have access to fixed-rate funds from Cagamas. But the formula for the pricing of medium-cost housing and low-cost housing units is such that the finance institutions are not lending at a fixed rate. Rather, the interest rate they can charge is a floating rate subject to a ceiling of 9% p.a. In fact, under this pricing formula, they are writing a call and put option at an interest rate of 9% in favor of the lending institution borrowers, thereby forcing the institution to forego any benefits from falling interest rates and exposing them to the risk of rising interest rates —without collecting any premiums that are normally due to an option writer. Given the tough stance BNM has taken on derivatives, the pricing rule with the embedded options it has imposed on commercial banks and finance companies is difficult to comprehend.

Origination

Until the early '70s the building societies were the biggest originators and providers of housing finance. Commercial banks and finance companies emerged as originators and providers only in the late '60s. In the mid-'70s the THLD also emerged as a major player in the housing loan market, providing end financing to public sector employees at a subsidized rate.

In 1960 and 1970 MBSB (or rather its precursor MBBS) provided 96.8% and 58.1% respectively of end financing; but by 1975 its share had declined dramatically to 16.9%, and by 1984 it had dipped below the 10% level.[6] By 1996 its share had dwindled to 2.8%.

Commercial banks whose market share was nil in 1960 and 26.3% in 1970 emerged as the dominant players by the mid-'70s with a market share of 38.5% in 1975. By the late 70s their market share had surpassed 40% and touched almost 45% in 1980. From the mid-80s until the early 90s, the market share of commercial banks dipped below 40% because the THLD emerged as an equally important provider of housing finance. In fact, from the mid-80s (except in 1985 and 1986) the THLD was the biggest originator of housing loans. In the 90s there has been a significant decline in the position of the THLD (possibly because of the decline in the relative size of the public sector and because many of the public sector employees who are eligible for housing loans have taken their loans, and there have been no further improvements in their loan entitlements).

The commercial banks once again emerged as the major player in the origination market in the 90s. Their market share surpassed 40% in 1993 and climbed to almost 50% by 1996. The finance companies, which have been licensed to operate essentially as providers of consumer finance from the late '60s, increased their market share from 7.8% in 1970 to 12.4% in 1976. Their market share, which had oscillated between 11.1% to 12.4% from 1976 to 1989, rose fairly sharply in the 90s, touching the high of 17.8% in 1996.

What Happened to Building Societies?

What factors accounted for the decline of the building societies and the emergence of commercial banks, the THLD and finance companies as the major originators and providers of housing finance? As a commercial bank is a one-stop provider of various financial services, it has a distinct competitive advantage over such specialized institutions as a building society and even a finance company. But a finance company is not significantly better off than a building society in this regard; yet the latter has fared very poorly even compared to a finance company.[7]

The precipitous decline in the market share of building societies (namely of MBSB and BHMFB) has also been blamed on the alleged funding constraints they face. This is not really true. The two building societies have been enjoying the status of a prescribed corporation from their inception. This confers on them the right to take deposits from the public, whether individual or institutions, without restrictions.

In fact, as these societies are not members of the Association of Banks or Finance Companies, and as they are not subject to the supervision of BNM, there are no restrictions on their deposit-taking powers. On the other hand, the rules of BNM and their Associations impose a restriction on the commercial banks and finance companies on the tenor of the deposits they can take and require them to offer the same rates on retail as well as institutional deposits of designated maturities. The societies also are not subject to the regulations of BNM, including its regulations with respect to reserve and liquid asset requirements as well as priority sector lending guidelines. As a result, building society cost of funds, (adjusted for risk), would be lower than that of a commercial bank or finance company, and their returns on shareholders funds would not be constrained by such considerations.

The phenomenal growth of the THLD in the 70s and 80s was thus based on institutional considerations rather than on market factors.

Financing and Refinancing

There is a difference in the origination and financing of housing loans. Cagamas is not involved in origination but only in refinancing. Cagamas buys housing loans from the originators and finances them through the issue of private debt securities.

Cagamas commenced operations in 1987. It refinanced 2% of housing loans outstanding that year but increased it to 10% by 1989. After a lackluster performance in 1990 and 1991, the percentage of housing loans refinanced increased to 14% in 1992 and 1993 and jumped to 21% in 1994. In fact, refinancing by Cagamas stood close to 27% in 1996.

Refinancing of housing loans through their sale to Cagamas grew rapidly for two reasons. First, through such refinancing an originating bank has been able to significantly reduce the mismatch in the maturity profile of its housing loans of 15 years or more and its deposits of one year or less. Second, as the private debt securities that Cagamas issues for the refinancing operation qualify as eligible liquid assets, the resulting lower cost of refinancing these loans reduces the financial burden of an originating bank in making mandated loans to housing and increases the realizable profit margin on its non-mandated lendings. The financial advantage from such refinancing will be higher so long as the reserve and mandated lending requirements as well as general interest rates are higher, and so long as there continues to be a shortage in the supply of papers which qualify as eligible liquid assets relative to the demand for such papers.

Role of Cagamas

The mismatch in the maturity profile of a finance institution's housing loan portfolio and its deposit liabilities can expose it to liquidity risk as well as interest-rate risk. With respect to its housing loan portfolio, a finance institution in Malaysia is running an interest-rate risk only on its mandated housing loan program for houses costing RM100,000 and less, as these loans are subject to an interest rate ceiling.[8] In the high-interest-rate environment of the 1980s, from 1980 to 1986, from two-thirds to three-fourths of a finance institution's housing loan portfolio would have been subject to interest rate control.[9] Given the bad interest rate experience of the early and mid-80s, the finance institutions were more than ready to utilize the refinancing opportunities provided by Cagamas from the late '80s (as born out by the data quoted earlier) in spite of the much lower interest rates prevailing during the period (and in spite of such mandated housing loans becoming more profitable in the changed interest-rate environment).[10] The big pick-up in refinancings in the mid-'90s was due to a steep fall in the cost of refinancings (on a fixed-rate basis) as a result of a shortage of eligible liquid assets (which drove down yields on Cagamas papers) and changed monetary conditions.

The two buildings societies, in spite of their funding constraints, were the only financial institutions which did not resort to refinancing with Cagamas.[11] The commercial banks were the most aggressive in using such refinancing opportunities.

By 1996 commercial banks had refinanced 36.2% of their housing loan portfolio, whereas the corresponding figures for finance companies and THLD were 30.1% and 11.0%. By resorting to such refinancing, both the commercial banks and finance companies were able to minimize their exposure to liquidity and interest-rate risk as well as free their capital for use in other areas of activities, including origination of new housing loans (which is the *raison d'être* for the development of the global market in securitized loans from the 1980s).

The early establishment of Cagamas put Malaysia ahead of the rest of the developing world in the development of securitization. However, the decision of the central bank (BNM) to prohibit the refinancing of housing loans for houses costing RM150,000 and above from the second quarter of 1997, as one of its selective measures to control credit, can constrain the growth of the securitization industry. One can certainly question the efficiency and equity of any program for the selective control of credit; but the only consolation is that it is a short-term and not a permanent measure. Regulatory constraints have also held back the development of the mortgage bond market.

Mandated Lending for Housing

Mandated lending to priority sectors including housing was introduced in 1976.[12] This was aimed at increasing the access of these sectors to credit as well as providing them with subsidized access to such credit. These mandated loans become more inefficient and inequitable when lending quotas are set above and interest-rate ceilings are set below market clearing levels, and even more so when these

controls are imposed simultaneously and are binding.

At the inception of the program in the mid-70s the priority sectors were agricultural food production, manufacturing, the bumiputra community, small scale enterprises and housing. Interest-rate ceilings were imposed on loans for food production, small scale enterprises, small scale loans to the bumiputra community and for houses costing RM100,000 or less. Manufacturing and food production ceased to be priority sectors beginning in 1983 and 1989 respectively. Loans to the bumiputra community ceased to be subject to interest-rate ceilings in 1989. Only loans to certain selected small scale enterprises were still subject to interest-rate ceilings. Lending for houses costing RM100,000 or less continued to be subject to interest-rate ceilings.

In 1985 about 25% of the loan portfolio of commercial banks was subject to interest-rate ceiling, whereas this was reduced to under 20% in 1989 and to under 5% in 1995. Furthermore, the interest-rate ceilings were less pernicious in the lower interest-rate environment of the late 80s and the 90s. The lending quotas were also less pernicious than interest-rate ceilings, as the quotas set were often below the market clearing levels. (For instance, if the quota is set at a preceding year's level or as a percentage of total loans in a preceding year which is below the actual for that year, then the target set can be deemed to be below that of the market clearing level in the Malaysian environment where loan growth has been generally very rapid.)

Impact of Mandated Lending

The banking crisis of the mid-80s was caused not only by the crisis the Malaysian economy went through in the early and mid-80s, but it was also caused by the overly ambitious and imprudent mandated lending program with interest-rate ceilings that had been imposed on the banking industry. In fact the BNM *Annual Report* for 1985 stated that as much as one-quarter of the loan portfolio of the commercial banks had been subject to interest-rate ceiling. Apart from these mandated loans to the so-called priority sectors, the banking industry was also used as a cheap source of finance for government expenditures, as its required holdings of liquid assets (then equal to 20% of a bank's eligible liabilities) had to be held directly or indirectly in the form mainly of government papers. The captive demand for these papers had driven down their yields in relation to a financial institution's funding cost and interest-rate risk. These lending and investment requirements drove up interest rates on non-priority sector loans (because of the cross-subsidies involved), curbed the volume of such lendings and hence reduced the profitability of banks. The high-interest-rate environment and poor economic conditions aggravated the problem.

The easing of interest rates and the liberalization of the mandated lending program since 1989 have assisted the banking industry considerably. In 1989 mandated lending under interest-rate ceilings were lower, around 19%, and given the lower interest-rate environment as well as the lower reserve and liquid asset requirements, the adverse impact on a bank's profitability was correspondingly lower. By 1995 mandated lending under interest-rate ceilings may have constituted under 5% of the banking industry's loan portfolio. As interest rates were lower than those prevailing in the first half of the 80s, the banking industry's balance sheet and profitability were much better (in spite of the higher reserve requirements).

Even if there is merit in the mandated lending program for housing and in the control of interest rates on housing loans for low-cost houses valued at RM25,000, there is certainly little or no merit in interest rate control on housing loans for medium-cost houses valued between RM25,000 and RM100,000. As we have noted earlier, there is little or no difference in the applicable rate for loans to the two categories. Available data show that about two-thirds to three-fourths of housing loans outstanding in the 80s and early 90s have been subject to interest rate control. This would suggest that of the universe of borrowers with housing loans, the proportion enjoying it at controlled interest rates is likely to be three-fourths or more. Most of these borrowers will be from the middle income group. Given that there are many poor individuals or households who cannot afford to buy even a low-cost house, one cannot justify on equity grounds the granting of housing loans at controlled interest rates to those who are better off, especially those who are purchasing medium-cost houses.

The case against is even stronger when one notes that the resulting interest subsidies will be at the expense of depositors and other borrowers, some of whom will be worse off than the preferred borrowers. A case in point is the low-income contributors to the Employees Provident Fund (EPF) which has been placing sizeable deposits with many financial institutions. To make matters worse, homeownership among many of these low-income contributors to EPF is dismally low. The practice of mandated lending at controlled interest rates is also inefficient to the extent that it curbs overall lending to the mandated activities or groups.

CONCLUSIONS

Housing loans may have absorbed 12.5% of the funds of the financial system flowing into lending activities in 1990 and 20.6% in 1995. The flow of funds into housing loans which are not financed by the financial system may have been as high as 7.5% in 1990 and 7.8% in 1995 when expressed as a percentage of the resources the financial system committed to its lending activities.

The changing dynamics of housing loans structured as term loan-cum-overdraft,

featuring an increase in tenor to 25 years, with provision for a periodic increase in monthy payments as well as for an inter-generational transfer of the loan, have been highlighted in the text. Reference has also been made to the recent introduction of Islamic housing loans which are analogous to a fixed-rate loan.

Until very recently, borrowers for high-cost housing units (defined as houses priced above RM100,000) could raise home loans only on a floating-rate basis; now, however, they have a choice of fixed-rate loans, but the supply is limited and the fixed-rate term is normally confined to a period of three-to-five years.

Currently the commercial banks are the biggest originators of housing loans, followed by the Treasury Housing Loan Division and the finance companies. The building societies, which were the biggest originators until the early 70s, accounted for a negligible share by the mid-90s. On the other hand, the commercial banks and finance companies emerged as originators only in the late 60s. The THLD emerged as an originator only in the early 70s, yet it was the biggest originator in the mid 80s.

There is a difference in the origination and financing of home loans. Cagamas is not involved in origination but only in refinancing. Cagamas commenced operations in 1987. It has played a critical role in reducing the liquidity and interest-rate risk of an end-financier arising from its asset-liability mismatch, as well as in reducing its cost of funds. The cost of funds has been reduced because of the designation of Cagamas papers as eligible liquid assets. The building societies, in spite of their (self-imposed) funding constraints, were the only financial institutions which did not resort to refinancing with Cagamas. The commercial banks were the most aggressive in using such refinancing opportunities. The early establishment of Cagamas put Malaysia ahead of the rest of the developing world in the development of securitization. However, the recent decision of BNM to prohibit the refinancing of home loans for houses costing above RM150,000 can constrain the growth of securitization in the country.

Mandated lending has been introduced into Malaysia since 1976 to increase access of priority sectors to credit and on subsidized terms. Mandated loans are inefficient and inequitable when lending quotas are set above and interest rate ceilings are set below market clearing levels, and even more so when these controls are imposed simultaneously. The only redeeming feature of mandated lending in Malaysia is that the lending quota has been usually set below the market clearing level. Despite this, from 1989 the quota applies only to certain classes of loans to small scale enterprises and for houses costing below RM100,000. This is generally in line with the increasing sophistication of the Malaysian economy. However, even if there is merit in the mandated lending program for housing and in interest-rate ceilings on low-cost housing units, there is no justification for imposing a ceiling on medium-cost housing units.

The private sector has played the dominant role in the financing of housing development as well as homeownership. Such financing has been readily available for house ownership. Financing for housing development is also readily available, but non-availability of data prevents us from quantifying its exact size. The breakdown for the financing of housing development can only be guessed at, as the published data are highly aggregated. This has been complicated further in recent years by the inclusion of certain categories of infrastructure financing (e.g., that of highways) within the data. No doubt BNM will have the breakdown for the current years and possibly for the earlier years.

The lack of such data also constrains informed discussion. This is unfortunate given the recent decision of the authorities to impose a ceiling on many categories of property loans on the ground that these loans are unproductive. The selective control of credit in the face of rapid monetary expansion can only provide a temporary relief as there are many obvious ways of circumventing such controls in the long run. There is in fact no alternative to monetary tightening.

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NOTES

[1] Apart from government service, the financial services industry is probably the only other industry offering subsidized housing loans as an integral part of employment contract.

[2] The OD tranche will enable the owner to draw on the underlying equity to finance his consumption or investment activities as and when required and at his discretion.

[3] One of the possible reasons for the lengthening of the tenor is due to the availability of funds from Cagamas to reduce the mismatch in the maturity profile of assets and liabilities of financial institutions engaged in the provision of home loans See the article by Huang Sin Cheng in this issue.

[4] The underlying assumption about prices and starting annual salaries are as follows respectively: Malaysia: RM30,000 and RM10,000 (early 70s) and RM150,000 and RM25,000 (90s); Singapore SGD300,000 and SGD 30,000; Australia: AUD75,000 and AUD 25,000.

[5] In assessing debt servicing ability, some banks are prepared to look at joint incomes of husband and wife or even that of their children (so long as the children can be made a party to the loan agreement either as a borrower or guarantor). Joint borrowing by brothers and sisters is also being accepted by some banks. In the case of chophouse purchase, joint borrowing by friends is usually accepted by banks. In assessing the debt servicing ability of a borrower, banks are prepared to take into account other sources of income. For instance, in respect to rental income a bank is prepared to take 50% of such rentals into one's income in assessing a borrower's ability to pay interest.

[6] BSB was incorporated in Singapore on March 29, 1950 under the name Colonial Building Society Ltd and it was renamed Malaya Borneo Building Society Ltd (MBBS) on March 9, 1956. It was re-incorporated in Malaysia as Malaysia Building Society Berhad (MBSB) on March 17, 1970.

[7] The major difference between a commercial bank and a finance company was that the latter could not operate a chequing account or lend on an unsecured basis, or engage in foreign exchange business; on the other hand, only a finance company could provide hire purchase finance. A building society could only engage in property and construction finance.

[8] There is no interest-rate control on loans to houses priced above RMIOO,OOO. As loans are priced on a variable-rate basis in line with the interest rate a financial institution pays on its deposits, it has little or no interest-rate exposure on such loans.

[9] The proportion of housing loans granted for houses costing RMIOO,OOO and less was 65.9% in 1982 and 64.3% in 1983. The corresponding numbers for 1988 to 1992 decreased from 68.7% to 64.3%. In 1996, "of the total number of houses approved for construction, 43.8% were high-cost housing units, 34.6% medium-cost housing and 21.6% low-cost housing units." Although these data are readily available to BNM, they have been seldom released in publicly available documents. One had to pour over many volumes of BNM's publications for these data. An economic analysis of such data is necessary mainly because loans extended for the purchase of low- and medium-cost houses are subject to a lending quota and an interest-rate ceiling, thus exposing the lender to interest-rate risk as well as possible financial losses.

[10] The formula for determining the interest rate on such loans was as follows: 1.75% + BLR or 9%, whichever was lower. Therefore, interest rate control made for a ceiling and not a floor interest rate, and a financial institution was not exposed to an interest risk in a lower interest-rate environment.

[11] These two building societies also failed to ease their funding constraints on loan growth arising from their limited deposit base through the issue of unsecured private debt securities.

[12] BNM set specific targets for the financing of low-cost houses only for the period 1986 to 1989. No separate targets have been set for the granting of housing finance for bumiputras from I990.